

STATEMENT OF PAUL M. TELLIER
PRESIDENT AND CHIEF EXECUTIVE OFFICER
CANADIAN NATIONAL RAILWAY COMPANY
BEFORE THE
SUBCOMMITTEE ON SURFACE TRANSPORTATION
AND MERCHANT MARINE
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE
HEARING ON RAILROAD MERGER RULES
JUNE 28, 2001

Mr. Chairman and Members of the Subcommittee:

On behalf of Canadian National Railway Company (CN) and its affiliates, I appreciate the opportunity to present our views on the new rules governing railroad mergers that were issued on June 11 by the Surface Transportation Board (STB) in STB Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures*.

By way of background, CN spans Canada and mid-America, from the Atlantic and Pacific Oceans, to the Gulf of Mexico. With extensive operations in Canada, as well as our activities in the U.S. and our reach into Mexico by virtue of our marketing alliance with the Kansas City Southern (KCS), we have a North American focus. We operate 15,500 route miles of track and we are the fifth largest of the seven Class I railroads operating in the United States, with annual operating revenues of approximately US\$3.5 billion.

CN appears before you today with a unique perspective on these merger rules. We are the most efficient railroad, with the best operating ratio of all

Class I railroads. Our objective since CN was privatized in 1995 has been to become the best railroad in North America by delivering high-quality service to our customers. We are committed to more efficient service and faster transit times for our customers, and we are committed to moving more freight, more quickly, with fewer assets. We are always seeking new ways to compete in the very dynamic transportation market.

To this end, we have undertaken a number of important initiatives. To capitalize on the rapidly-expanding market for north-south trade that has arisen as a result of the North American Free Trade Agreement (NAFTA), we merged with the Illinois Central Railroad (IC) in 1999 with no serious integration problems. We have undertaken alliances and entered into marketing agreements with other rail carriers. And, CN announced earlier this year our intent to merge with the Wisconsin Central Transportation Corporation (WC). All of these efforts make CN a stronger railroad and a more effective competitor, which in turn benefits our customers.¹

CN's Position on the New Merger Rules

¹ One initiative on which we were not successful was our attempt last year to combine the operations of CN with those of the Burlington Northern Santa Fe (BNSF) in a new company, North American Railways, Inc. We saw this essentially end-to-end transaction as good for shippers, competition, the economy, and the shareholders of CN and BNSF. However, the Board's review of our proposed combination was suspended with the STB's imposition in March 2000 of a 15-month moratorium on activity related to mergers of Class I rail carriers. CN and BNSF appealed the Board's decision to the U.S. Court of Appeals for the District of Columbia Circuit, but the Court denied our appeal. On July 20, 2000, CN and BNSF announced that we were abandoning plans for our combination. To this day, we have not revived those plans.

We are pleased that the rules adopted by the Board will raise the bar for the quality of customer service in future railroad mergers. The Board has said it will closely scrutinize claims of benefits made by future merger applicants and has imposed requirements intended to ensure that railroad customers receive the service envisioned by merger applicants. CN had urged the Board to adopt such an approach last year.

We also are particularly gratified that the Board appears to have heard the concerns raised by CN, Canadian Pacific, and the Government of Canada regarding the Board's proposed requirements related to transnational mergers. In the final rules, the Board now plans to apply higher public interest standards for mergers equally to all applicants – both domestic U.S. companies and foreign-headquartered corporations. If the goal of treating U.S. and foreign-headquartered railroads equally is met in the implementation of the rules, that will help stimulate competition in our industry.

In our comments during the Board's proceeding, we had expressed concerns about the Board's proposal that merger applicants identify "downstream" effects of a merger and the Board's proposed requirement that future mergers enhance competition. The new rules have taken steps to allay our concerns in these areas, but the implementation of these rules will be of vital importance. These rules should be a mechanism to promote efficiency and

service, not a way to induce artificial, economically unsustainable competition or to protect some carriers from competition with others.

It is also important to note that the enhanced competition that the Board seeks can also come through more efficient competition. One of the best actions carriers can take for their customers is to reduce costs and improve service. Mergers may still have an important role to play in helping the industry achieve that goal.

While we may not agree with all aspects of the new merger rules, CN believes that, if the rules are properly implemented, the rail industry will be able to operate effectively and will have the opportunity to bring good merger cases before the agency and receive a fair hearing.

Future Railroad Industry Structure

In its new merger rules, the Board appropriately emphasizes the importance of a renewed emphasis on improved customer service, which is essential if the railroad industry is to survive. How the industry will respond to new service challenges – and the new merger rules – is the subject of considerable speculation.

It is important to note that no particular industry structure is inevitable. It is, of course, possible that two major North American railroads will emerge, but that possibility is neither a certainty nor even a probability. Nor is there any reason to believe that the industry structure will ever become static. CN

believes the railroad industry will continue its long history of changing along with the economy at large, which is the only way rail can remain a competitive mode.

In recent years, we have seen the rail industry change dramatically with the economy. For example, short lines have re-emerged as an important rail sector. Similarly, NAFTA has increased the importance of improved north-south routes, which was one of the factors behind the Board's approval of the CN/IC merger in 1999. Other new forms of competition will undoubtedly emerge to meet future market needs. Similarly, new capabilities may emerge that will allow old structures to become effective in ways that are not yet possible.

CN believes that railroad customers can be the beneficiaries of a new railroad paradigm that emphasizes responsible growth and responsive customer service. Our industry will stagnate and deteriorate if it does not continue to grow by providing more and better services to our customers so that rail will always be an attractive alternative in this dynamic, multi-dimensional economy. For customers who rely entirely on railroads, we have to provide service that keeps them competitive in the global marketplace. For the vast majority of our customers, who have a choice between railroads and other modes, we have to make rail a better choice of transportation than the other modes. We also need to capture a part of the share of other modes, which have

the largest share of the freight transportation market – if we are to stay in business.

With respect to CN, we of course are always looking to the future and seeking new ways to improve our performance and enhance our customer service. However, we have no plans at this time to merge with another rail carrier. We are currently focusing solely on our proposed merger with Wisconsin Central and the ongoing regulatory review process at the STB surrounding that transaction.

Mr. Chairman, thank you again for the opportunity to appear before the Subcommittee on this important subject. I would be happy to answer any questions you might have.